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IN THE

Supreme Court of the United States

October Term, 1976

No. _____

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, DUPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & CO., CHARLESTON INVESTMENT COMPANY, E. D. SYSTEMS CORPORATION, DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON AND CHARLES W. COX,

Petitioners,

—against—

WINTHROP J. ALLEGAERT, as Trustee of duPont Walston Incorporated,

Respondent,

—and—

NEW YORK STOCK EXCHANGE, INC., DOUGLAS E. DETATA, JOHN J. DOUGHTY, ALLAN BLAIR, AND D. TIPP CULLEN,

Additional Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF RESPONDENT NEW YORK STOCK EXCHANGE, INC. IN SUPPORT OF PETITION

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TABLE OF CONTENTS

	PAGE
OPINIONS BELOW	1
JURISDICTION OF THE COURT	2
QUESTION PRESENTED	2
STATUTES AND RULES INVOLVED	2
STATEMENT OF THE CASE	2
REASONS FOR GRANTING THE WRIT	
I. THE DECISION BELOW UNDERMINES EXCHANGE SELF-REGULATION AS CONTEMPLATED BY THE EXCHANGE ACT AND AS PRACTICED BY NATIONAL SECURITIES EXCHANGES	4
II. THE DECISION BELOW FINDS NO SUPPORT IN ANY STATUTE OR IN ANY DECISION OF THIS COURT	10
CONCLUSION	10

TABLE OF AUTHORITIES

PAGE

CASES

American Safety Equipment Corp. v. *J. P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968) ---------- 9

Brown v. *Gilligan, Will & Co.*, 287 F.Supp. 766 (S.D. N.Y. 1968) ---------- 5

Gordon v. *New York Stock Exchange, Inc.*, 422 U.S. 659 (1975) ---------- 4

In re the Revenue Properties Litigation Cases (Cohn, Delaire & Kaufman), 451 F.2d 310 (1st Cir. 1971) 7

Nolde Brothers, Inc. v. *Local No. 358, Bakery & Confectionery Workers Union*, 97 S. Ct. 1067 (1977)-- 7

Silver v. *New York Stock Exchange*, 373 U.S. 341 (1963) ---------- 4

STATUTES

Bankruptcy Act

Section 26, 11 U.S.C. § 49 ---------- 2

Section 60b, 11 U.S.C. § 96b ---------- 2

Section 67d, 11 U.S.C. § 107d ---------- 2

Section 70e, 11 U.S.C. § 110e ---------- 2

Securities Act of 1933

Section 14, 15 U.S.C. § 77n ---------- 2

Securities Exchange Act of 1934

Section 6, 15 U.S.C. § 78f ---------- 2

Section 10(b), 15 U.S.C. § 78j(b) ---------- 2

Section 19, 15 U.S.C. § 78s ---------- 2, 7

Section 21, 15 U.S.C. § 78u ---------- 7

Section 22, 15 U.S.C. § 78v ---------- 7

Section 23, 15 U.S.C. § 78w ---------- 7

Section 25, 15 U.S.C. § 78y ---------- 7

Section 28(b), 15 U.S.C. § 78bb(b) ---------- 2, 5

Section 29(a), 15 U.S.C. § 78cc(a) ---------- 2

PAGE

United States Arbitration Act

Section 2, 9 U.S.C. § 2 ---------- 2

Section 3, 9 U.S.C. § 3 ---------- 2

OTHER AUTHORITIES

Bankruptcy Rules

Rule 919(b) ---------- 2

Exchange Constitutions and Rules

American Stock Exchange Constitution, Art. VIII, 2 AM. STOCK EX. GUIDE (CCH) ¶ 9062-- 5

Boston Stock Exchange Constitution, Art. IX, § 3, BOSTON STOCK EX. GUIDE (CCH) ¶ 1203-- 5

New York Stock Exchange Constitution, Art. VIII, § 1, 2 NYSE GUIDE (CCH) ¶ 1351 ----- 5

New York Stock Exchange Rule 482, 2 NYSE GUIDE (CCH) ¶ 2482 ---------- 5

Pacific Stock Exchange Constitution, Art. XII, §§ 1, 2, PACIFIC COAST STOCK EX. GUIDE (CCH) ¶¶ 1801, 1806 ---------- 6

Securities and Exchange Commission Rules

Rule 10b-5, 17 C.F.R. 240.10b-5 ---------- 2

SEC, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H.R. Doc. No. 95, 88th Cong., 1st Sess., Pt. 1 (1963) ---------- 4

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BRIEF OF RESPONDENT NEW YORK STOCK EXCHANGE, INC. IN SUPPORT OF PETITION

Opinions Below

The opinion of the United States District Court for the Southern District of New York is reproduced in the petition at Appendix B. The opinion of the United States Court of Appeals for the Second Circuit, reported at 548 F.2d 432, is reproduced in the petition at Appendix A.

Jurisdiction of the Court

The Court's jurisdiction is invoked under 28 U.S.C. § 1254(1). The judgment sought to be reviewed was entered on January 25, 1977.

Question Presented

A question presented, vital to all national securities exchanges, is whether arbitration of exchange members' disputes, required by exchange constitutions and rules, can be compelled in disputes involving claims arising under the federal securities laws and the Bankruptcy Act. The Court below held that, except for "mere internal brokerage industry squabble[s]," such arbitration cannot be compelled.

Statutes and Rules Involved

This case involves Sections 2 and 3 of the United States Arbitration Act (9 U.S.C. §§ 2 and 3); Sections 26, 60b, 67d, and 70e of the Bankruptcy Act (11 U.S.C. §§ 49, 96b, 107d, and 110e); Section 14 of the Securities Act of 1933 (15 U.S.C. § 77n); Sections 6, 10(b), 19, 28(b), and 29(a) of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78f, 78j(b), 78s, 78bb(b), and 78cc(a)); Securities and Exchange Commission Rule 10b-5 (17 C.F.R. 240.10b-5); and Bankruptcy Rule 919(b).

Statement of the Case

The case is well stated in the petition. This brief deals with the role of New York Stock Exchange, Inc. (the "Exchange") in the case and the effect of the decision below on national securities exchanges and the principle of self-regulation embodied in the Securities Exchange Act of 1934 ("Exchange Act").

Respondent, the trustee (the "Trustee") of duPont Walston Incorporated ("Walston"), named the Exchange

as a defendant, charging it with conspiring with the other defendants to defraud Walston and with violating the Exchange's regulatory duties under Section 6 of the Exchange Act in connection with the realignment in July 1973 of the businesses of Walston and duPont Glore Forgan Incorporated, then two of the Exchange's largest member organizations.

In the District Court, petitioners moved to stay the action pending arbitration. The Exchange is not a party to any arbitration agreement and therefore could not join in petitioners' motion. However, the Exchange did move to stay the action as to it on the ground that arbitration between the Trustee and the petitioners would resolve many of the issues pertaining to the Exchange and might render the action moot. The Exchange argued that a denial of its motion would result in duplicative effort with a consequent waste of time and money for the Court and parties and would create the possibility of inconsistent results.

Judge Knapp granted the Exchange's motion, staying the action as to the Exchange and the four non-moving defendants pending conclusion of arbitration, which he directed be held between petitioners and the Trustee.

The Trustee appealed. The Court below reversed, holding that the Trustee should proceed in the District Court with his Bankruptcy Act and securities laws claims. Noting that these claims "involve so many of the basic factual and legal issues underlying the [T]rustee's remaining claims," the Court below suggested that none of the Trustee's claims be permitted to proceed to arbitration.

The Court below held that the order staying the action against the Exchange was interlocutory and not appealable. It observed, however, that it would be an abuse of the District Court's discretion to continue the stay in view of the Court of Appeals' decision precluding arbitration.

Reasons for Granting the Writ

I. THE DECISION BELOW UNDERMINES EXCHANGE SELF-REGULATION AS CONTEMPLATED BY THE EXCHANGE ACT AND AS PRACTICED BY NATIONAL SECURITIES EXCHANGES.

While the purpose of the Exchange Act was to establish a comprehensive regulatory scheme for the securities industry, "[t]he pattern of governmental entry . . . was by no means one of total displacement of the exchanges' traditional process of self-regulation." *Silver* v. *New York Stock Exchange,* 373 U.S. 341, 352 (1963). *See also Gordon* v. *New York Stock Exchange, Inc.,* 422 U.S. 659, 663-67 (1975). Rather, the Exchange Act imposed a scheme of "supervised self-regulation," which "involves control of exchange markets by requiring or permitting national securities exchanges to adopt rules governing their practices and procedures and the business conduct of their members, and in each case imposes the responsibility for enforcement of these rules on the exchanges themselves." SEC, Report of Special Study of Securities Markets, H. R. Doc. No. 95, 88th Cong., 1st Sess., Pt. 1 at 3 (1963). "Instead of giving the Commission the power to curb specific instances of abuse, the Act placed in the exchanges a duty to register with the Commission . . . and decreed that registration could not be granted unless the exchange submitted copies of its rules, . . . and unless such rules were 'just and adequate to insure fair dealing, and to protect investors'. . . ." *Silver* v. *New York Stock Exchange, supra* at 352.

In implementing the Congressional policy of exchange self-regulation, the Exchange's Constitution, Article VIII, § 1, provides:

> "Any controversy between parties who are members, allied members, member firms or member corporations shall, at the instance of any such party, and any controversy between a non-member and a member or allied member or member firm or member corporation arising out of the business of such member, allied member, member firm or member corporation, or the dissolution of a member firm or member corporation, shall, at the instance of such non-member, be submitted for arbitration, in accordance with the provisions of the Constitution and the rules of the Board of Directors." (2 NYSE Guide (CCH) ¶ 1351)

This provision, which by its terms reaches "any controversy" and, specifically, claims arising out of the "dissolution of a member firm," comprehends the Trustee's claims. Similar provisions are found in the constitutions and rules of other national securities exchanges.* "[E]very member, by virtue of his admission, contracts to be governed by the conditions of membership which the exchange has imposed. These conditions are, therefore, binding on the members, and constitute virtually a body of law by which the members are governed in their dealings with the exchange and with each other." *Brown* v. *Gilligan, Will & Co.,* 287 F.Supp. 766, 769 (S.D.N.Y. 1968), *quoting* C. H. Meyer, The Law of Stock Brokers and Stock Exchanges § 7 (1931).

Moreover, the authority of exchanges to provide for settlement of their members' disputes is given express recognition in Section 28(b) of the Exchange Act, 15 U.S.C. § 78bb(b), which provides:

> "Nothing in this chapter shall be construed to modify existing law with regard to the binding effect . . . on any member of or participant in any self-regulatory organization of any action taken by the authorities of such organization to settle disputes between its members or participants. . . ."

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* *See, e.g.,* American Stock Exchange Constitution, Art. VIII, 2 Am. Stock Ex. Guide (CCH) ¶ 9062; Boston Stock Exchange Constitution, Art. IX, § 3, Boston Stock Ex. Guide (CCH) ¶ 1203; Pacific Stock Exchange Constitution, Art. XII, §§ 1, 2, Pacific Coast Stock Ex. Guide (CCH) ¶¶ 1801, 1806.

Here, petitioners and Walston qualify as those entitled to compel arbitration of each other's claims. Petitioners moved to compel arbitration. The District Court granted the motion. The Court below reversed. The effect of the decision below is to limit the disputes as to which arbitration can be compelled to "mere internal brokerage industry squabble[s]." Not only does this limitation seriously erode an important aspect of self-regulation, but the standard prescribed by the decision below leaves future disputants in a quandary over whether their dispute is a "mere . . . industry squabble" or "of a character inappropriate for arbitration."

There are advantages to arbitration, whether the controversy is individual or institutional in nature. Arbitration is a much quicker method of settling disputes. Prompt settlement of disputes furthers an exchange's interest in fostering harmonious relations between its members. Arbitration also is less expensive. The immediate beneficiaries of reduced costs are the parties themselves. Ultimately, however, these savings in the cost of doing business are passed along to the investing public.*

Furthermore, disputes in the securities industry may involve complicated concepts and terminology unique to the industry, as does this case. The thrust of the Trustee's claims is that the net capital, financial, and record-keeping condition of the duPont firm at the time of the realignment was not as it had been represented to Walston. An analysis of those aspects of the condition of the duPont firm requires the ability to comprehend highly technical ingredients of brokerage accounting and record-keeping. For this reason, arbitration before a panel knowledgeable in the

* The Exchange subsidizes the arbitration which it sponsors. Parties to arbitration presently are taxed between $350 and $550 per session. To the extent that costs exceed this levy, the Exchange makes up the difference. Exchange Rule 482, 2 NYSE GUIDE (CCH) ¶ 2482. For 1977 the Exchange has budgeted approximately $450,000 in support of its arbitration facility, approximately the same amount which it expended in each of the three previous years for that purpose.

intricacies of the securities industry is superior to protracted litigation in the federal courts.* Resoluton of disputes by persons familiar with the industry also would eliminate the costly and time-consuming need to "educate" a jury.

If a dispute between exchange members raises important questions of social policy or requires corrective action on behalf of interests not adequately represented in a private arbitration proceeding—both concerns of the Court below—then the Exchange Act provides ample authority for separate, public proceedings by or under the auspices of the SEC.**

Nevertheless, the Court below cited unarticulated "public policy" reasons which amounted to the proposition that arbitration is inappropriate in this case because it is a case involving broad questions of policy and that somehow the machinery of arbitration is not adequate to cope with such cases. This concern previously had been considered and rejected by the Court of Appeals for the First Circuit in *In Re the Revenue Properties Litigation Cases (Cohn, Delaire & Kaufman)*, 451 F.2d 310, 313-14 (1st Cir. 1971):

> "[White, Weld] points out that if it is compelled to arbitrate, issues important to the securities industry could be decided, with only the limited review envisaged by 9 U.S.C. § 10. The logic of this argument implies a prerequisite to arbitrability: that only issues not heavily invested with legal significance be decided. But no area of arbitration is guaranteed to be kept insulated from important issues of substantive law. A labor-management arbitration agreement could not be imagined to contain the caveat, 'except when an important or novel construction of the National Labor-

* For much the same reason, this Court recently endorsed arbitration in the context of a labor-management dispute. *Nolde Bros., Inc.* v. *Local No. 358, Bakery &Confectionery Workers Union*, 97 S. Ct. 1067, 1073 (1977).

** *See* Exchange Act, Sections 19, 21, 22, 23, and 25 (15 U.S.C. §§ 78s, 78u, 78v, 78w, and 78y).

> Management Relations Act is involved'. . . . If, under 15 U.S.C. § 78j(b), for example, the cause of action—use of a deceptive device violative of the rules of an exchange—is suitable for arbitration, as we would most certainly think it is, we would not know where to draw the line beyond which arbitration—with all its benefits and all its risks—could not take place."

The decision of the Court below, limiting the availability of arbitration to certain ill-defined "intramural situations," also gives rise to the anomalous result that public investors who seek arbitration of their claims may be thwarted by exchange members who contend in federal court, *e.g.*, that theirs is a dispute raising questions under the federal securities laws or "rais[ing] broad questions of policy which ordinarily should be handled by the judiciary." Thus, under the fluid "appropriateness" test promulgated by the Court below, members of the public could be denied the speedy and inexpensive determination of their disputes afforded by arbitration, which they are entitled to compel under the constitutions and rules of exchanges.* Indeed, seven of the petitioners are nonmembers of the Exchange who seek speedy and inexpensive resolution of their dispute arising out of their dealings with a member organization.

There is nothing in the record or in the circumstances of this case to suggest that arbitration is inappropriate to resolve the Trustee's claims. Arbitration has successfully resolved in the past many cases "rais[ing] broad questions of policy," and there is no basis for the belief that here arbitration procedures will prove inadequate or that the arbitrators will be unfair. This case exhibits no special circumstances to warrant the result reached below. The arbitration agreements which the Trustee would avoid were

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* Between 1974 and 1976, inclusive, Exchange arbitration panels processed 879 new cases and concluded 975 cases. Of the cases concluded, 490 involved a dispute between a member of the public and a member of the Exchange community.

freely entered into by experienced and sophisticated brokers from two of the Exchange's largest member organizations who had full knowledge of the consequences of their actions and eminent legal counsel. Walston (and its successor in interest, the Trustee) requires no special dispensation from its commitment to arbitrate.

Unlike *American Safety Equipment Corp.* v. *J. P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968), from which the Court below adopted its three-pronged "appropriateness" test, this case does not involve claims based on "contracts of adhesion between alleged monopolists." (391 F.2d at 827) The Exchange's Constitution and Rules and those of the American Stock Exchange have been reviewed and approved by the SEC. Walston was required to subscribe to the Exchange's arbitration requirement as a condition of Exchange membership. That requirement is recognized by the Exchange Act and has been approved by the SEC as part of the comprehensive regulatory scheme, which should not be judicially dismantled.

Adoption of the "appropriateness" test by the Court below will undermine the effectiveness of countless arbitration agreements and undoubtedly will require the attention of the federal courts on a case-by-case basis. Under the decision below, not only will cases "inappropriate" for arbitration be brought to the federal courts, but also those cases in which the broker opposing arbitration can raise a colorable argument of inappropriateness. Claims of fraud under the federal securities laws will be pleaded to avoid arbitration of ordinary brokerage and corporate transactions subject to arbitration clauses. The transaction attacked in this suit is not unusual. Brokerage firms are continually merging or realigning their businesses. Unfortunately, brokerage firms often go bankrupt, too. Avoidance of arbitration clauses via the route mapped out by the decision below has no basis in any act of Congress and furthers no federal interest. On the contrary, it will frustrate the Congressional policy embodied in both the Exchange Act and the Arbitration Act, and needlessly increase

the caseload of an overburdened federal court system with cases that always have been well handled by arbitration within the securities industry.

II. THE DECISION BELOW FINDS NO SUPPORT IN ANY STATUTE OR IN ANY DECISION OF THIS COURT.

The decision of the Court of Appeals below deviates from the general rule that arbitration of exchange members' disputes, required by the constitutions and rules of exchanges, is binding and will be enforced by the courts. Point II, sections A and B of the petition well set forth and discuss the authorities. Those sections are adopted by reference.

CONCLUSION

The petition should be granted because of the damage the decision below will work on self-regulation as contemplated by the Exchange Act and as practiced by national securities exchanges. Upon review, the decision below should be reversed.

Respectfully submitted,

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April 25, 1977